



REPORT OF THE DIRECTORS

The Directors have pleasure in submitting their report together with the audited accounts of the Company and its subsidiaries (collectively the “Group”) for the year ended 31 December 2004.

Principal activities and analysis of operations

The Company was incorporated on 10 March 2004. The principal activity of the Company is investment holding. The activities of the Company’s subsidiaries (set out in Note 33 to the accounts) are primarily ship owning, ship chartering and the provision of ship management services. An analysis of the Group’s performance for the year by business segment is set out in Note 3 to the accounts.

Results and appropriations

The results of the Group for the year are set out in the consolidated profit and loss account on page 55.

The Group’s dividend policy is to pay out by way of interim and final dividends not less than 50% of profits available for distribution in each financial year. For 2004, dividend payments are based on the results for the period from 1 June to 31 December 2004 because all retained earnings up to 31 May 2004 were paid out to shareholders of the Company prior to the reorganisation of the Group and the Listing.

In view of the above dividend policy and taking into consideration the Group’s performance and current financial position, the Directors have recommended the payment of a final dividend of HK\$0.16 (equivalent to US\$0.02) per share for the financial year ended 31 December 2004. When this proposed final dividend is aggregated with the mid-period interim dividend of HK\$0.08 (equivalent to US\$0.01) per share declared on 13 December 2004, the total payout of HK\$0.24 per share represents 56% of the Group’s profits for the seven months ended 31 December 2004. The proposed final dividend for 2004 of HK\$0.16 per share is to be considered at the 2005 Annual General Meeting scheduled for 29 April 2005.

Henceforth it is anticipated that the normal sequence of dividend declarations will be an interim dividend following the announcement of interim results and a final dividend following the announcement of full year results.

Reserves

Movements in the reserves of the Group and of the Company during the year are set out in Note 28 to the accounts.

Donations

Charitable and other donations made by the Group during the year amounted to US\$52,000.

Fixed assets

Details of the movements in fixed assets of the Group during the year are set out in Note 13 to the accounts.

Share capital

Details of the movements in share capital of the Company during the year are set out in Note 27 to the accounts.

Distributable reserves

Distributable reserves of the Company at 31 December 2004, calculated under Companies Act 1981 of Bermuda, amounted to US\$26.4 million.

Pre-emptive rights

There is no provision for pre-emptive rights under the Company's bye-laws and there was no restriction against such rights under Bermuda Law.

Financial summary

A summary of the results and of the assets and liabilities of the Group for the last four-financial years is set out on page 98.

Purchase, sale or redemption of securities

During the year, neither the Company nor any of its subsidiaries had sold or redeemed any of the Company's shares with the exception of the re-purchase by the Company of 53,329.40 Class A shares, 63,990.96 Class B shares and 2,682.64 Class C shares at purchase prices of US\$1 in respect of each class of share by private arrangement pursuant to a board resolution passed on 11 May 2004.

Share option scheme

Share options are granted to certain Directors, senior management and employees under a share option scheme approved by shareholders on 17 June 2004 (the "Share Option Scheme").

(a) *Purpose and eligible participants of the Share Option Scheme*

The Share Option Scheme enables the Company to grant options to eligible participants (and their related trusts and companies), principally directors, employees, secondees, shareholders, business partners, agents, consultants or representatives, customers of the Group or of any Controlling Shareholder, suppliers of goods and services and persons or entities that provide research, development, advisory, consultancy or professional services to the Group or any Controlling Shareholder, as an incentive or reward for their contributions to the Group.

(b) *Maximum number of shares*

The total number of shares available for issue under options which may be granted under the Share Option Scheme or any other schemes must not, in aggregate, exceed 126,701,060 shares, representing 10% of the shares in issue at the time dealings in the shares first commenced on the Hong Kong Stock Exchange. As at 31 December 2004, 55,500,000 shares were granted under the Share Option Scheme which represents 4.38% of the issued share capital of the Company.



(c) *Limit for each eligible participant*

The aggregate number of shares issued and to be issued upon exercise of options granted in any 12-month period to an eligible participant (including both exercised and outstanding options) shall not exceed 1% of the shares in issue as at the date of grant.

(d) *Basis of determining the exercise price*

The exercise price payable on exercise of the options under the Share Option Scheme shall be determined by the Board and notified to each grantee. The exercise price shall not be less than the higher of: (i) the closing price of the shares as stated in the Hong Kong Stock Exchange's daily quotations sheet on the date of grant of that option, which must be a business day; (ii) the average of the closing prices per share as stated in the Hong Kong Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant of that option; and (iii) the nominal value of the shares.

All notices to exercise the options shall be accompanied by a remittance for the full amount of the subscription price for the shares in respect of which the notice is given.

(e) *Remaining life of the scheme*

The Share Option Scheme will remain in force for a period of 10 years commencing on 14 July 2004 being the date the shares were listed on the Hong Kong Stock Exchange. Upon termination, no further options may be granted under the Share Option Scheme.

(f) *Share options granted*

Details of the share options outstanding as at 31 December 2004 which have been granted under the scheme are as follows:

	Number of Options				exercise price	Percentage of issued share capital
	held at 1 January 2004	granted during the year	exercised during the year	held at 31 December 2004		
					HK\$	
Executive Directors						
Christopher R. Buttery	—	4,800,000	—	4,800,000	2.50	0.38%
Mark M. Harris	—	4,800,000	—	4,800,000	2.50	0.38%
Paul C. Over	—	4,800,000	—	4,800,000	2.50	0.38%
Senior Management	—	21,600,000	—	21,600,000	2.50	1.70%
Other Employees	—	19,500,000	—	19,500,000	2.50	1.54%
	—	55,500,000	—	55,500,000		

Note: The share options were granted on 14 July 2004 and vest over three years. One-third of the options may be exercised one year after the date of grant, one-third two years after the date of grant and one-third three years after the date of grant. All options will expire on 13 July 2014.

(g) *Valuation of the Share Option Scheme*

Based on a report prepared by Watson Wyatt Hong Kong Limited on 15 October 2004, the fair market value of the share options granted under the Share Option Scheme based on the binomial option pricing model is as follows:

Tranche	Exercise period	Fair value per share option	Number of share options as at date of grant
		HK\$	
1	14 July 2005 to 13 July 2014	0.838	18,500,000
2	14 July 2006 to 13 July 2014	0.839	18,500,000
3	14 July 2007 to 13 July 2014	0.825	18,500,000
			55,500,000

Note: Key assumptions include an expected dividend yield of 8% per annum, volatility of the Company's share price of 50% per annum, a risk-free rate of interest of 4% per annum and that the employees will exercise their share options if the share price is 100% above the exercise price.

Save as disclosed above, no right to subscribe for the securities of the Company nor its associated corporations within the meaning of the Securities and Futures Ordinance (the "SFO"), has been granted by the Company to, nor have any rights been exercised by any person during the year.



Directors

The Directors who held office during the year and up to the date of this report are set out below:

Name of Director	Date of Appointment				Term of appointment
	Board	Audit Committee	Remuneration Committee	Nomination Committee	
Executive Directors					
Christopher R. BUTTERY (Chairman)	15 March 2004	—	—	—	3 years from 1 April 2004
Mark M. HARRIS (Group Chief Executive)	15 March 2004	—	—	—	3 years from 1 April 2004 ⁽¹⁾
Paul C. OVER	15 March 2004	—	—	—	3 years from 1 April 2004 ⁽¹⁾
Non-Executive Directors					
Simon K.Y. LEE (Deputy Chairman)	15 March 2004	—	15 September 2004	1 March 2005	12 months from 5 June 2004 ⁽¹⁾
Brian P. FRIEDMAN	15 March 2004	—	15 September 2004	1 March 2005	12 months from 5 June 2004 ⁽¹⁾
James J. DOWLING	15 March 2004	—	—	—	12 months from 5 June 2004 ⁽¹⁾
Independent Non-Executive Directors					
Patrick B. PAUL Chairman of Audit Committee	25 March 2004	18 May 2004	10 June 2004	30 November 2004	3 years from 28 May 2004 ⁽¹⁾
Robert C. NICHOLSON Chairman of Remuneration and Nomination Committee	25 March 2004	18 May 2004	10 June 2004	30 November 2004	3 years from 28 May 2004 ⁽¹⁾
The Earl of CROMER	25 March 2004	18 May 2004	10 June 2004	30 November 2004	3 years from 28 May 2004 ⁽¹⁾

Note:

- (1) Per Bye-law 87(1), one-third of the Directors (except the Chairman of the Board) shall retire from office by rotation at each annual general meeting and retiring Directors shall be eligible for re-election at the annual general meeting.

In accordance with Bye-law 86(2) of Bye-laws of the Company, Patrick B. Paul, Robert C. Nicholson and The Earl of Cromer, the three independent non-executive directors, all appointed by the Board, shall be eligible for re-election at the forthcoming 2005 Annual General Meeting.

In accordance with Bye-laws 87(1) & (2), Mark M. Harris will retire at the forthcoming 2005 Annual General Meeting and, being eligible, will offer himself for re-election.

Directors' service contracts

None of the Directors who are proposed for re-election at the forthcoming 2005 Annual General Meeting has a service contract with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

Directors' interests in contracts of significance

No contracts of significance in relation to the Group's business to which the Company was a party and in which a Director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Biographical details of Directors and senior management

Brief biographical details of Directors and senior management are set out on page 10 to 15.

Directors' and Chief Executives' interests and short positions in the shares and underlying shares and debentures of the Company or any associated corporation

At 31 December 2004, the discloseable interests and short positions of each Director and the Chief Executive in the shares, underlying shares and debentures of the Company and its associated corporations within the meaning of Part XV of the SFO, as recorded in the register maintained by the Company under Section 352 of the SFO or as notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") were as follows:

Name of Director		Personal interests	Corporate interests	Trust & similar interests	Total share interests	Percentage of issued share capital
Christopher R. Buttery	Long Positions	100,000	—	12,059,623 ⁽¹⁾	12,159,623	0.96%
	Short Positions	—	—	—	—	—
Paul C. Over	Long Positions	—	—	12,059,623 ⁽²⁾	12,059,623	0.95%
	Short Positions	—	—	—	—	—
Brian P. Friedman	Long Positions	—	241,195,194 ⁽³⁾	—	241,195,194	19.04%
	Short Positions	—	—	—	—	—
Simon K.Y. Lee	Long Positions	—	—	36,536,997 ⁽⁴⁾	36,536,997	2.88%
	Short Positions	—	—	—	—	—

Notes:

- (1) 12,059,623 shares are beneficially owned by Plymouth Shipping Investments Limited, which is wholly owned by Turnwell Limited and Ansleigh Limited in equal shares. Mr. Buttery is deemed to be interested in the entire share capital of Turnwell Limited under the SFO as its shares are held by a discretionary trust set up by him and the discretionary objects of which include himself and his family members.
- (2) 12,059,623 shares are beneficially owned by Plymouth Shipping Investments Limited, which is wholly owned by Turnwell Limited and Ansleigh Limited in equal shares. Mr. Over is deemed to be interested in the entire share capital of Ansleigh Limited under the SFO as its shares are held by a discretionary trust set up by him and the discretionary objects of which include himself and his family members.
- (3) Mr. Friedman is a managing member of FS Private Investments LLC, which is the manager of each of Furman Selz Investors II L.P., FS Employee Investors LLC and FS Parallel Fund LP, being the members of IDB Carriers (BVI) Limited. Under these arrangements, Mr. Friedman is entitled, as a managing member of FS Private Investments LLC, to exercise or control the exercise of rights conferred by the holding of all the shares in IDB Carriers (BVI) Limited. Accordingly, Mr. Friedman is taken to be interested in the 241,195,194 shares held by IDB Carriers (BVI) Limited.
- (4) 1,059,725 shares, 22,335,373 shares and 13,141,899 shares are beneficially owned by Firelight Investments Limited, Eagle Pacific International Limited and Eagle Sky Investments Limited respectively. These companies are controlled by discretionary trusts established by Mr. Lee, the discretionary objects of which include his family members.



Share options were granted to certain Directors under the Share Option Scheme and have been disclosed on page 44.

Save as disclosed above, at no time during the year was the Company, its subsidiaries, or its associated companies a party to any arrangement to enable the Directors and Chief Executives of the Company to hold any interests or short positions in the shares or underlying shares in, or debentures of, the Company or its associated corporation.

Substantial shareholders' interests and long and short positions in the shares and underlying shares of the Company

The register of substantial shareholders maintained under Section 336 of the SFO shows that as at 31 December 2004, the Company had been notified of the following substantial shareholders' interests and short positions, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors and Chief Executive.

Name of Shareholder	Capacity/Nature of interest		Number of shares	Percentage of issued share capital
Dry Bulk Shipping (BVI) Limited	Beneficial owner	Long Positions	289,433,689	22.84%
		Short Positions	—	—
IDB Carriers (BVI) Limited	Beneficial owner	Long Positions	241,195,194	19.04%
		Short Positions	—	—
Nassau Capital Real Estate Partners III L.P. ⁽¹⁾	Interest of a controlled corporation	Long Positions	289,433,689	22.84%
		Short Positions	—	—
Furman Selz Investors II L.P. ⁽²⁾	Interest of a controlled corporation	Long Positions	241,195,194	19.04%
		Short Positions	—	—
FS Private Investments LLC ⁽²⁾	Interest of a controlled corporation	Long Positions	241,195,194	19.04%
		Short Positions	—	—
James L. Luikart ⁽³⁾	Interest of a controlled corporation	Long Positions	241,195,194	19.04%
		Short Positions	—	—
Pembroke Shipping Limited	Beneficial owner	Long Positions	179,589,622	14.17%
		Short Positions	—	—

Notes:

- (1) Nassau Capital Real Estate Partners III L.P. is interested in approximately 40% of the registered capital of Dry Bulk Shipping (BVI) Limited and is deemed or taken to be interested in these shares and to hold this short position (which are beneficially owned by and attributable to Dry Bulk Shipping (BVI) Limited respectively) for the purposes of the SFO.
- (2) Furman Selz Investors II L.P. is interested in approximately 88.2% of the registered capital of IDB Carriers (BVI) Limited, and FS Private Investments LLC is the manager of Furman Selz Investors II L.P. with power to control the exercise of voting rights attached to these Shares. Therefore Furman Selz Investors II L.P. and FS Private Investors LLC are deemed or taken to be interested in these shares and to hold this short position (which are beneficially owned by and attributable to IDB Carriers (BVI) Limited respectively) for the purposes of the SFO. FS Private Investments LLC does business under the name of Jefferies Capital Partners.
- (3) Mr. Luikart is a managing member of FS Private Investments LLC, which is the manager of each of Furman Selz Investors II L.P., FS Employee Investors LLC and FS Parallel Fund LP, being the members of IDB Carriers (BVI) Limited. Under these arrangements, Mr. Luikart is entitled, as a managing member of FS Private Investments LLC, to exercise or control the exercise

of rights conferred by the holding of all the shares in IDB Carriers (BVI) Limited. Accordingly, Mr. Luikart is taken to be interested in these shares and to hold this short position (which are beneficially owned by and attributable to IDB Carriers (BVI) Limited respectively) for the purposes of the SFO.

Management contracts

No contracts concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

Major customers and suppliers

During the year, the Group sold less than 30% of its goods and services to its five largest customers and purchased less than 30% of its goods and services from its five largest suppliers.

Connected transactions

During the year ended 31 December 2004, the Group had the following connected transactions:

(i) *Insurance services from Sun Hing Insurance Brokers Limited ("Sun Hing")*

Sun Hing has been appointed as a provider of insurance services to the Group on a non-exclusive basis, pursuant to an agreement dated 4 June 2004 which expires on 31 December 2006. Sun Hing has provided such services in connection with arranging insurance policies in respect of vessels owned, chartered or managed by the Group. Sun Hing has also provided insurance services in respect of the general affairs of the Group. Such services were provided to the Group on commercial terms and in the ordinary course of Sun Hing's business.

Sun Hing is approximately 35% owned indirectly by, and therefore an associate (as defined under the Listing Rules) of, Mr. Simon K.Y. Lee, one of the Directors of the Company.

For the year ended 31 December 2004, premiums payable to Sun Hing amounted to US\$0.2 million which is within the approved cap of US\$0.4 million as disclosed in the Company's prospectus dated 30 June 2004 (the "Prospectus").

(ii) *Technical management services from A.M. Nomikos Transworld Maritime Agencies S.A. ("Nomikos")*

China Line Shipping Limited ("China Line") (a jointly-controlled entity of the Group) entered into a technical management agreement dated 11 January 2001 with Nomikos for the provision by Nomikos, as agents for and on behalf of China Line, of crew management, technical management, insurance arrangements, accounting services and supply of provisions in respect of a vessel of China Line named m.v. Captain Corelli. Such agreement (as amended, the "Technical Management Agreement") was amended by a supplemental agreement dated 18 June 2004, pursuant to which it will terminate on 31 December 2006.

The management fee payable under the Technical Management Agreement is subject to annual review on 11 January. The fees charged by Nomikos are on Nomikos' ordinary trading terms. All expense incurred by Nomikos thereunder on behalf of China Line are payable by China Line to Nomikos.



Nomikos, on the basis of the Company's understanding that it is connected with Myrtos Inc., a substantial shareholder in a company which is a jointly controlled entity of the Company (albeit treated by the Listing Rules as one of the Company's subsidiaries), namely Pacific Basin Bulker (No.103) Corporation, which in turn wholly owns China Shipping Limited;

The management fee payable under the Technical Management Agreement for the period from 1 April 2004 to 31 December 2004 amounted to US\$0.1 million which is within the approved cap of US\$0.1 million as disclosed in the Prospectus.

(iii) *Commercial management services to Redcliffe Shipping Limited ("Redcliffe")*

Redcliffe, the owner of m.v. Derwent (the "Vessel"), entered into a commercial management agreement with Pacific Basin Shipping (UK) Limited ("PBSUK") (a wholly owned subsidiary of the Company) effective as of 23 June 2003 for the provision by PBSUK of commercial management services in respect of the Vessel. Such agreement (as supplemented) expires on 31 December 2006, may be terminated on one month's notice by Redcliffe to PBSUK or following the sale of the Vessel, and provides for a monthly management fee and a commission on such a sale payable to PBSUK. Such management fees and commissions are in accordance with PBSUK's ordinary trading terms and in the ordinary course of its business.

Redcliffe is owned indirectly as to one-third by each of, and therefore an associate (as defined under the Listing Rules) of, Mr. John Davis and Mr. Anthony Foster, both being ex-directors of PBSUK, which is a subsidiary of the Company.

The Vessel was sold and delivered in September 2004 and the fees payable by Redcliffe to PBSUK amounted to US\$0.04 million which is within the approved cap of US\$0.2 million as disclosed in the Prospectus.

(iv) *Information technology services and equipment from Clear Future Technologies Limited ("CFT")*

CFT has been appointed as a provider of information technology services and equipment to Pacific Basin Shipping (HK) Limited, a subsidiary of the Group, on a non-exclusive basis and on normal commercial terms pursuant to a master consulting services agreement dated 10 June 2004 and which expires on 31 December 2006.

CFT is controlled indirectly as to approximately 70% by, and therefore an associate (as defined under the Listing Rules) of, Mr. Simon K.Y. Lee, one of the Company's Directors.

For the period from 1 April 2004 to 31 December 2004, fees payable by the Group to CFT amounted to US\$6,000 which is within the approved cap of US\$0.1 million as disclosed in the Prospectus.

(v) *Administrative services to Epic Shipping (BVI) Limited ("Epic")*

The Company entered into a services agreement with Epic dated 17 June 2004 and having effect from 1 April 2004 under which the Company agrees to provide accounting and treasury, systems support and other administrative services to Epic and its subsidiaries after the listing date until 31 December 2004.

Epic is considered a connected person in accordance with the Listing Rules since its shareholders are substantially the same as those of Pembroke Shipping Limited ("Pembroke") (a substantial shareholder of the Company) and the same shareholders are members of the Controlling Group. Epic is the owner of the excluded activities of Pembroke, comprising the ownership and management of oil product tankers, a UK-based ship management business and ownership interests in two small newbuilding bulk carriers as disclosed in the Prospectus.

The above services agreement was terminated on 31 December 2004 and fees payable by Epic for the period from 1 April 2004 to 31 December 2004 amounted to US\$0.1 million which is within the approved cap of US\$0.5 million as disclosed in the Prospectus.

Pursuant to the waiver letter issued by the Hong Kong Stock Exchange in respect of the above transactions stated in (i), (iii) and (v), these connected transactions could be exempted if certain conditions are fulfilled such as the confirmation from independent non-executive directors that these transactions satisfy the following conditions:

- (a) the continuing connected transactions disclosed above were entered into by the Group in the ordinary and usual course of business;
- (b) the continuing connected transactions have been entered into on an arm's length basis and conducted either on normal commercial terms, or where there is no available comparison, on terms no less favourable to the Group than those available to or from independent third parties; and
- (c) the continuing connected transactions have been entered into in accordance with the agreements governing such transactions on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The independent non-executive directors of the Company are satisfied that the above conditions had been fulfilled in 2004.

Compliance with the Code of Best Practice of the Listing Rules

Throughout the year, the Company was in compliance with the Code of Best Practice as set out in the Appendix 14 of the Listing Rules. Please also refer to the Corporate Governance section.

Audit Committee

Details of the Audit Committee are set out in the Corporate Governance section.

Subsequent events

Details of significant subsequent events are set out in Note 32 to the accounts.

Auditors

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.



Public Float

On the basis of information that is publicly available to the Company within the knowledge of the Directors as at the date of this report, the Company has complied with the public float requirements of the Listing Rules.

By Order of the Board

Andrew T. Broomhead
Company Secretary

Hong Kong, 1 March 2005

Pacific Basin Shipping Limited

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